Issues Facing Transportation Funding in Virginia: Increasing the Gas Tax is not a Long-Term Solution

Introduction:

Transportation funding is one of the biggest challenges facing not only the Commonwealth of Virginia, but the nation at-large. Nearly every year, state legislatures in every corner of the country grapple with the difficult question of how to provide the adequate revenues to maintain the nation's aging infrastructure, as well as provide the necessary capacity and transportation alternatives to meet the needs of our growing population and economy. Further, despite the recent adoption of a new surface transportation authorization – Moving Ahead for Progress in the 21st Century (MAP-21) – the debate at the federal level will soon resume, as the Highway Trust Fund will face new deficits when the authorization expires in two years.

While a number of states and the federal government have increasingly been looking toward non-traditional sources of revenue for transportation, as well as innovative methods to leverage available revenues, much of the debate at both the state and federal level has focused on the motor fuels tax. Here in Virginia, each General Assembly session brings with it a variety of different bills to increase or adjust the motor fuels tax. Each year, the political debate around these proposals grows and little progress is made.

As the debate over the motor fuels tax continues, the dynamics behind the conversation must change if there is ever to be progress toward a long-term solution. Like it or not, the motor fuels tax is an outdated revenue source. Increasing the rate of taxation on motor fuels would undoubtedly provide a short-term boost in revenues, but certain structural aspects of the motor fuels tax will forever prevent such an increase from addressing the Commonwealth's and the nation's long-term transportation needs.

Transportation Funding in Virginia:

Unlike most aspects of government in the Commonwealth, transportation is not principally funded with General Fund revenues. Revenues for transportation are primarily generated through a number of different taxes and fees that are specifically dedicated to transportation, with the potential for one-time deposits, primarily from General Fund year-end surpluses.

The largest source of state transportation revenue comes from Virginia's motor fuels tax. The Commonwealth levies a 17.5 cents per gallon Motor Vehicle Fuels Tax on gasoline and diesel fuel. This tax is levied in addition to the federal motor fuels tax, which ranges from 18.3 cents per gallon on gasoline to 24.3 cents per gallon on diesel fuel. The Commonwealth also levies a five cents per gallon Aviation Fuels Tax and a 21 cents per gallon Road Tax, which is administered under the International Fuels Tax Agreement.

After the motor fuels tax, the largest sources of revenue are transportation's 0.5% share of the state's general 5% sales and use tax and the 3% Motor Vehicle Sales and Use Tax. The 1986

Special Session of the General Assembly raised the state sales and use tax by 0.5% and specifically dedicated this revenue to transportation. Another large source of transportation revenue is the Commonwealth's Motor Vehicle License or Registration Fee. A fee of $40.75 is levied on vehicles under 4,000 pounds, while vehicles over 4,000 pounds are charged overweight permit fees that vary based on their weight.

The Commonwealth also levies a number of other miscellaneous taxes and fees, some of which are exclusively dedicated to transportation, while are others shared with various other programs. These taxes and fees include:

- A 10% Motor Vehicle Rental Tax on gross vehicle rentals;
- A $15 road usage fee under the International Registration Plan;
- $0.25 per $100 of the Recordation Tax;
- One-third of the Insurance Premiums Tax; and
- Defined transportation tax districts
- Other miscellaneous license and permit fees.

These revenues, as well as the Commonwealth's annual federal allocation, are deposited into the Commonwealth Transportation Fund (CTF). Within the CTF, the specific use revenues are distributed and the remaining amounts are sub-allocated by Virginia Code to two primary accounts: the Highway Maintenance and Operating Fund (HMOF) and the Transportation Trust Fund (TTF). Revenues in the HMOF are used to support highway maintenance and agency operations. Revenues in the TTF, after providing for the Virginia Space Flight Authority, are allocated among the different transportation modes, with 78.7% going to highway construction, 14.7% going to mass transit, 4.2% going to ports, and 2.4% going to airports. Some of these funds are then further allocated by formula within the respective mode of transportation.

Based upon current revenue projections for FY 2013, the Commonwealth's transportation revenues are estimated at just over $4.6 billion. The major state revenues sources are as follows:

Highway Maintenance and Operating Fund	**FY 2013 Revenue**
Motor Fuels Tax	$729,000,000
Road Tax	$5,100,000
Motor Vehicle Sales and Use Tax	$354,100,000
International Registration Plan	$62,600,000
Motor Vehicle Licenses	$220,400,000
Misc. Revenues	$12,800,000
Recordation Tax	$12,800,000
Total HMOF	**$1,396,800,000**

Transportation Trust Fund	FY 2013 Revenues
Motor Fuels Tax	$108,000,000
Road Tax	$7,400,000
Aviation Fuels Tax	$2,200,000
State General Sales and Use Tax	$543,300,000
Motor Vehicle Sales and Use Tax	$188,800,000
Motor Vehicle Rental Tax	$33,300,000
Licenses Fees	$21,400,000
Recordation Tax	$25,600,000
Total TTF	**$930,000,000**

Notes: FY 2013 federal revenue projected at $1.09 billion
Chart does not include federal funds, bond proceeds, toll facilities, interest earnings and other revenues sources

Issues Impacting the Motor Fuels Tax:

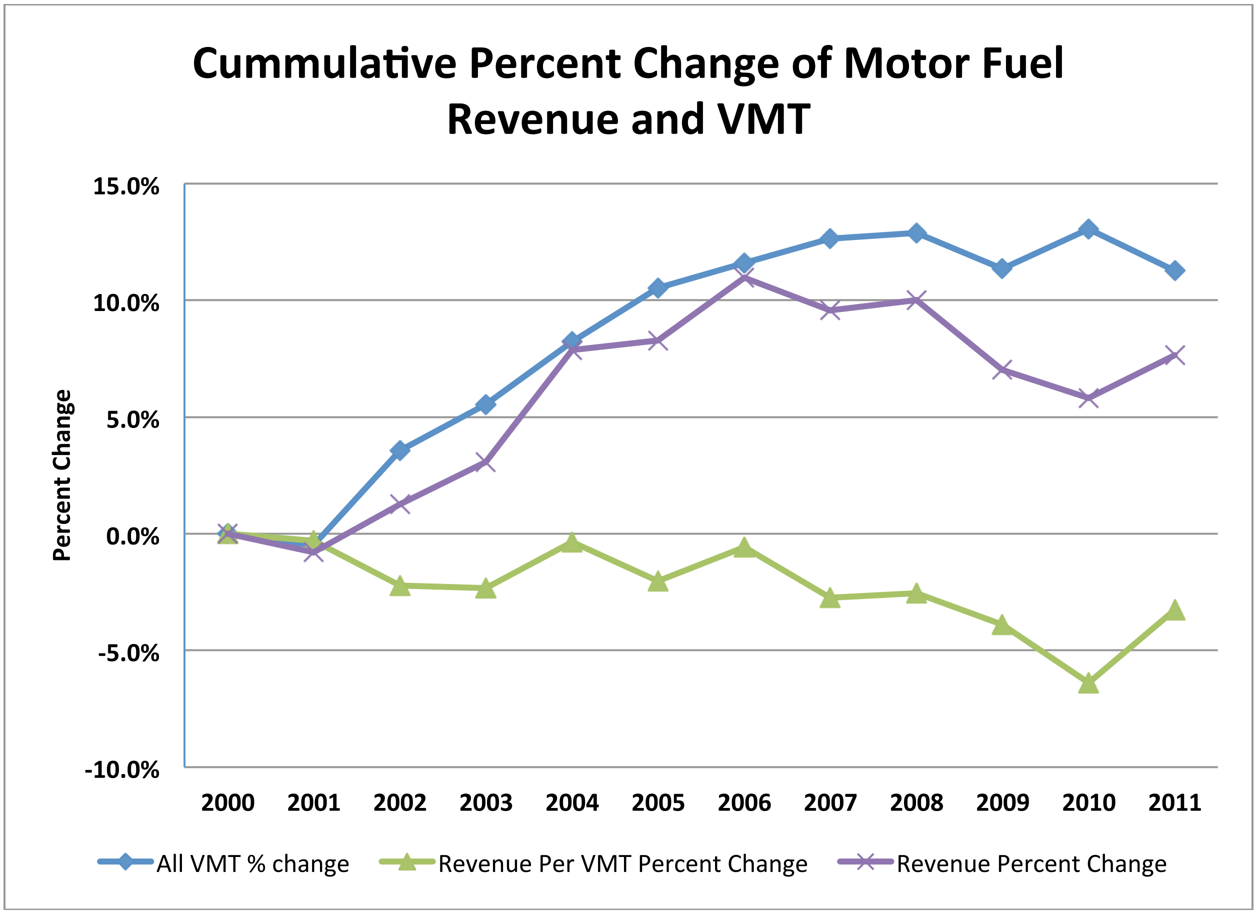
As stated previously, the motor fuels tax is the largest source of state funding for transportation. The current rate of taxation, 17.5 cents per gallon, was established during the 1986 Special Session, the last time the motor fuels tax was adjusted. At that time, the General Assembly chose not to add an inflation factor, better known as indexing, to the motor fuels tax. As a result, much of the recent debate in Virginia over the motor fuels tax has revolved around its declining value.

Without an inflation factor, the value of the Commonwealth's motor fuels tax has significantly declined. The 17.5 cents per gallon rate of taxation in 1986 dollars is worth only about 8 cents today. Consequently, the value of Virginia's motor fuels tax revenues has declined by approximately 55%.

This decline in purchasing power or value of the Commonwealth's motor fuels tax revenues is a problem in and of itself because while purchasing power is down, the costs of maintaining and constructing the Commonwealth's roadways is sky rocketing. For example, since 2002, the binder for asphalt, which is an oil based derivative, has increase by 350%. Additionally, the costs of the fuel necessary to operate much of the equipment used in maintaining and constructing our roadways has increased significantly over the past several years.

While this situation could be moderated by indexing the motor fuels tax to account for inflation, such a move would not, however, address the overriding structural issues that underlie the Commonwealth's reliance on the motor fuels tax as the largest source of transportation funding. Historically, as the nation has faced economic recessions, motor fuels tax revenues have decreased, yet they have almost always quickly rebounded. For the first time, despite an increase in registered vehicles and vehicle miles traveled (VMT), motor fuels tax revenues have not rebounded.

Since 2002, there has been a steady increase in the number of registered vehicles, and the number of vehicle miles traveled each year continues to grow. However, corresponding increases in the net fuels tax collections have not occurred. In fact, motor fuels tax collections still remain substantially below pre-recession levels and are at the second lowest point since 2003. This means that the Commonwealth is collecting less revenue per vehicle mile traveled.



Since 2000, the amount of revenue collected per vehicle mile traveled has decreased by 6.4%. As more vehicles travel more miles on the Commonwealth's roadways, maintenance and capacity needs grow. However, as the chart above shows, the Commonwealth is collecting less revenue from these vehicles, meaning the funds for addressing these issues continue to decline. In other words, if you look at the increase in the number of registered vehicles and VMT as indicators of the amount of damage caused to a roadway, there is not corresponding increase in the amount of revenue generated by these vehicles to address this damage; there is actually a decrease.

This downward trend is indicative of the underlying structural problems with relying on the motor fuels tax as the primary source of transportation funding. As vehicles become more fuel efficient with increasing Corporate Average Fuel Economy (CAFE) and greenhouse gas emission standards, and more and more people turn to alternative fuel vehicles, the motor fuels tax becomes more and more outdated and insufficient for funding transportation. Further, both the CAFE standards and the sale of alternative vehicles are projected to continue to increase.

In fact, according to the National Highway Traffic Safety Administration website, the goal is to increase the required average industry fleet-wide basis for cars and trucks to 40.1 miles per gallon in 2021 and 49.6 miles per gallon in 2025, up from 29.7 in 2012. To achieve this combined average will mean that passenger cars will need to average 56 miles per gallon, while light trucks will have to average 40.3 miles per gallon by 2025.

Additionally, while it is nearly impossible to predict the future of the alternative fuel vehicle market, statistics show that, with the exception of 2010, there is steady growth in the industry. Further, as new alternative vehicles enter production, sales are projected to grow substantially. For example, some auto makers, such as Ford, saw over 10% growth in their hybrid vehicles in 2011, while Chevy saw Volt sales grow 2,253.07% and sales of the Nissan Leaf grew by 50,815.19%.

Governor McDonnell's Plan:

Put simply, the lack of an inflation factor, growing CAFE standards, and increased use of alternative fuel vehicles means Virginia is deriving less revenue from each vehicle traveling our roadways. While increasing and indexing the motor fuels tax would provide a boost to Virginia's transportation revenues in the short-term, such a move would not address the long-term challenges posed by Virginia's reliance on the gas tax. Ten years down the road, Virginia would be in the same position, having the same arguments over how to address transportation funding.

That is why Governor McDonnell is proposing to replace the 17.5 cents per gallon gas tax with a 0.8% increase in the sales and use tax. Unlike gas tax revenues, sales and use tax revenues grow with the economy, and as percentage of the value of a good, the sales and use tax inherently accounts for inflation. Further, there is a direct link between transportation and economy activity and growth. Converting to the sales tax as the principle funding stream for transportation, ensures that transportation's funding is tied to the economic growth it supports.

Over the next five years, replacing the gas tax with the sales tax will generate over $600 million in additional revenues for transportation. This change is not a tax increase. Rather, the additional revenue is derived from the overall higher rate of growth associated with the sales tax. Moreover, this change, when coupled with the other changes contemplated by Governor McDonnell's plan will provide the necessary reforms to ensure that Virginia has an adequate transportation system well into the future.